



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	02/25/02	Bill No:	AB 2809
Tax:	Sales and Use	Author:	Longville
Board Position:		Related Bills:	SB 10xxx (Sher)

BILL SUMMARY

This bill would define “marketplace” for purposes of the partial sales and use tax exemption for sales of diesel fuel used in farming activities.

ANALYSIS

Current Law

Existing law imposes a sales or use tax on the gross receipts from the sale of, or the storage, use, or other consumption of, tangible personal property, unless specifically exempted by statute. Under existing law, sales of diesel fuel are generally subject to sales or use tax. However, Section 6357.1 was added to the Sales and Use Tax Law by AB 426 (Ch. 156, 2001) to provide a state General Fund sales and use tax exemption that became operative on September 1, 2001, for the sale and purchase of diesel fuel used in farming activities and food processing.

Section 6357.1 defines “farming activities” by reference to Section 263A of the Internal Revenue Code, and further specifies that “farming activities” also includes the transportation and delivery of farm products to the “marketplace.”

Current law requires that the sales tax revenue from the sale of diesel fuel be allocated on a quarterly basis to the Public Transportation Account. The money transferred to the Public Transportation Account is generally used to fund public transit projects.

Proposed Law

This bill would amend Section 6357.1 of the Sales and Use Tax Law to specify that “farming activities” includes the transportation and delivery of farm products to the marketplace, *whether that transportation and delivery is made by a person directly engaged in a “farming business” as set forth in Section 263A of the Internal Revenue Code, or by that person’s agent.*

Further, the bill would define “marketplace” to mean the first place at which both of the following conditions are met:

- 1) Title to the farm products has been or is transferred, and
- 2) Possession of the farm products is transferred to a person not engaged in a “farming business” as set forth in Section 263A of the Internal Revenue Code.

The bill would become operative January 1, 2003.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board’s formal position.

Background

In order to properly administer the diesel fuel exemption incorporated into the Sales and Use Tax Law, and to provide guidance to affected diesel fuel sellers, the Board drafted proposed Regulation 1533.2, *Diesel Fuel Used in Farming Activities or Food Processing*, to interpret and make specific the provisions contained in Section 6357.1. At its January 9, 2002 hearing, the Board's Business Taxes Committee authorized publication of the proposed regulation. A public hearing on proposed Regulation 1533.2 will be held on March 27, 2002.

In the proposed regulation, "farming activities" is defined to include transporting an agricultural commodity from the trade or business that produced it to the marketplace, including transporting the commodity to a facility to prepare it for the marketplace (such as for cooling, sorting, packing, slaughtering, inspecting, and other similar tasks), so long as the producer of the commodity maintains a financial interest in such commodity.

The proposed regulation also clarifies that the term "food processing" includes transporting the farm or processed food product from the trade or business that produced the commodity to the processing plant, between processing plants of the same entity, including transporting the processed food product to the first point of sale.

COMMENTS

- 1. Sponsor and Purpose.** This bill is sponsored by the California Transit Association. According to the author's office, its purpose is to clarify undefined terms referenced in Section 6357.1 in order to address Governor Davis' signing message which states, "...Some technical corrections to this measure will, however, be required. In order to better clarify the intent of the 2001-02 budget agreement between the Administration and the Legislature, the State sales tax exemption for diesel fuel used in farming should better define that it is intended only to apply to delivery to the first destination from the farm. This will target the benefits to those intended – the farmers. ...". The author believes that the provisions proposed in the Board's regulation would extend the scope of the exemption beyond the Legislature's and Governor's intent, and as a result, would have a corresponding revenue impact to the revenues allocated to the State's Public Transportation Account.
- 2. Proposed terms in the bill still leave uncertainty.** The bill would define "farming activities" for purposes of narrowing the scope of the exemption for farmers' use of the diesel fuel. However, the language of the bill continues to leave uncertainty with respect to the scope of the exemption for food processors. For example, would the fuel used by the food processor to transport partially processed food products between various divisions of the same food processing entity for further processing operations be included, or would the diesel fuel used in transporting the partially processed food to another food processor qualify?

Another source of confusion in the proposed language is the reference to the agent. The bill would specify that diesel fuel used in the transportation of the farm products by a farmer's agent would qualify. Farmers may prepare and market their products through a cooperative, joint venture, corporation or partnership in which they have a

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financial interest, or other such enterprises. Would the diesel used in these enterprises to transport products to the marketplace qualify? Would food processors qualify as “agents.” In order to address these ambiguities, staff is willing to work with the author’s office in developing language that reflects the author’s intent.

3. **Proposed regulation would eliminate inequities.** At the public hearing on the proposed regulation, industry representatives expressed concern that if the term, “marketplace” meant the first point of sale of the farm products, an inequity would be created between differently sized and organized agricultural enterprises. Using an example of an independent chicken farmer versus Foster Farms, industry argued that with respect to the independent chicken farmer, the diesel fuel exemption would apply to the point in which the farmer transferred the chickens to the food processor. That food processor would thereafter receive no benefit of the diesel fuel exemption on his or her transportation of the product. However, with respect to Foster Farms that raises and processes its own chicken, the entire portion of the diesel fuel used in transporting these products by Foster Farms up until the chicken is sold would qualify for the exemption from tax. Industry pointed out that this would place food processors who do not produce their own farm products at a competitive disadvantage with respect to the larger producers/processors. Enactment of this measure would not address this inequity.
4. **Related Legislation.** SB 10xxx (Sher, et al.) has also been introduced to address this issue. That measure is essentially the same as AB 2809, with the exception that it contains legislative findings and declarations.

COST ESTIMATE

Some additional administrative workload would be incurred in notifying affected retailers, responding to inquiries, and redrafting the proposed regulation. These costs are expected to be absorbable.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

This estimate has been prepared with the assumption that the intent is to amend the bill to more narrowly define the extent to which food processors would benefit from the exemption than that which has been proposed in the Board’s regulation.

Based on information from the U.S. Census Bureau’s 1997 Economic Census, Transportation and Warehousing – California, we estimate that the diesel fuel expenditures for the transportation and delivery of farm products to the place where these products are sold to the ultimate consumer amounted to \$1.12 billion. This bill would limit the exemption to the transportation of the farm products to the place where the farmer sells his products. We estimate that the annual diesel fuel expenditures for the transportation and delivery of farm products to the place where these products are first sold amount to \$119.4 million. This estimate is based on the transportation of agricultural products by firms engaged in the transportation of agricultural products.

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Specifically the estimate includes only those firms operating specialized vehicles for this purpose. The estimate is overstated to the extent that there are instances where the farmer sells his products to a processor or wholesaler at his farm and the farm products would be transported by the buyer. In such cases, the diesel fuel used in the transportation of the farm products would not be exempt under the proposed amendment. The estimate is also understated to the extent that the farm products are transported by firms that are engaged in general trucking services and do not use specialized vehicles.

This bill would exempt the estimated \$119.4 million in diesel expenditures and would subject an estimated \$1 billion in diesel fuel expenditures to the state sales and use tax. At the current 5% state sales and use tax rate, this would result in a revenue gain of \$50 million.

Pursuant to Section 7102 of the Revenue and Taxation Code, 4.75% of the 5% state sales tax on diesel fuel used on-highway is transferred from the General Fund to the Public Transportation Account. This bill would increase the amount transferred to the Public Transportation Account by \$47.5 million and the remaining \$2.5 million would go to the General Fund.

Revenue Summary

The revenue gain from limiting the state sales and use tax exemption for diesel fuel used in the transportation of farm products by defining the marketplace as the point where the farmer sells his products would be as follows:

	<u>Revenue Gain</u>
State General Fund (0.25%)	\$ 2.5 million
Public Transportation Account (4.75%)	47.5 million
Total	\$ 50.0 million

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